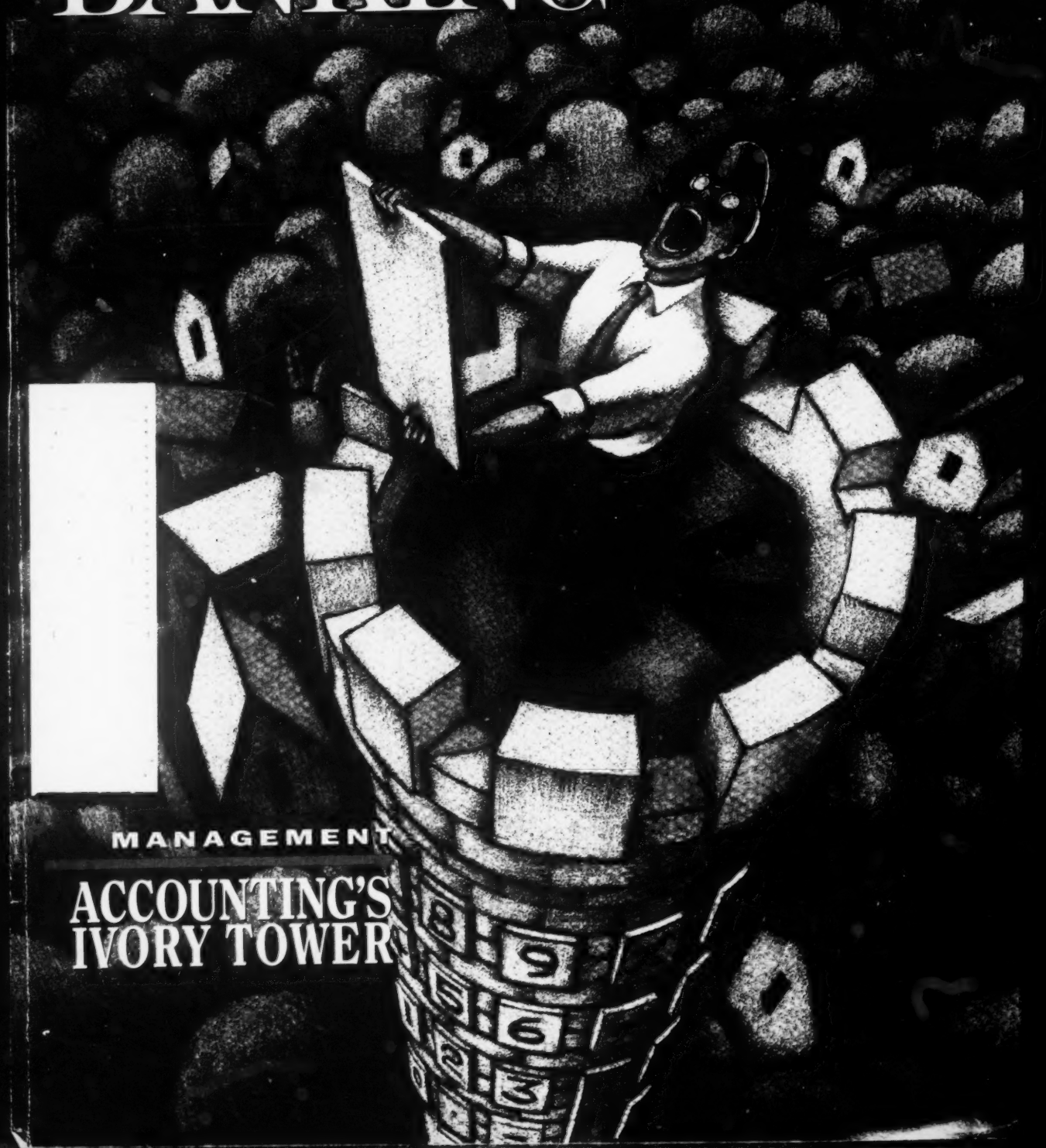
SEPTEMBER 1991

MORTGAGE BANKING

THE MAGAZINE OF REAL ESTATE FINANCE



MANAGEMENT

ACCOUNTING'S IVORY TOWER

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Accounting's official rulemakers often make policy that doesn't quite mesh with the view from the street. Companies must jump through intricate hoops to meet the letter of the law set by these gurus of GAAP. It may be that accounting has its own view of reality because its rulemakers—the Financial Accounting Standards Board—try to make reporting practices uniform and meaningful. That's a lofty mission where the end product frequently loses a little something as it drifts down from the clouds.

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PORTFOLIO

Accounting Lingo

Accounting exerts its totalitarian hold on business practices in many fundamental ways. Mortgage banking is no different. The behavior that accounting rules spawn appears extremely convoluted, as businessmen bend their strategic plans around the strange bumps in the terrain that accounting dictums produce.

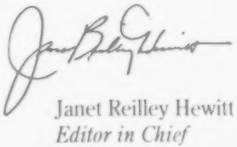
But the rules are important ones at least to accountants and their most senior brethren—the policymakers at the Financial Accounting Standards Board (FASB). FASB policymakers are seeking to forge a utopian world where what's on the balance sheet is meaningful to all who read it and where assets are accounted for in a way that truly reflects the value that lies therein. But what often arises is a kind of looking-glass world where things are done in very peculiar ways solely for accounting purposes.

This issue is devoted to corporate management issues, and accounting is certainly one of those issues that top management must wrestle with. One of our authors provides an account of the many micropieces of the industry that are under examination currently by various FASB task forces or emerging-issues analysts or the other rocket scientists of modern financial accounting.

This issue also covers recent findings from important work being done by KPMG Peat Marwick in Washington, D.C. to delve into the mysteries of portfolio and operational traits that lead to higher and lower servicing costs. These findings are breaking new ground that could lead mortgage banking's senior managers to find the path to maximizing servicing income.

Finally, the issue also profiles the evolution of effective new hedging tools to cover one of the biggest risks affecting buyers of servicing—prepayments. And an annual report card from the Mortgage Bankers Association of America's economics department on how servicers did in controlling costs and generating income rounds out an issue filled with data to help the industry's managers and their companies prosper, in spite of the accountants.

EDITOR'S NOTE: In our August issue, in the article titled "The Factors Driving Wholesale," Phillip Bracken's company prior to its recent purchase should have been identified as America's Mortgage Company. Also, in the July issue, a chart on page 42 that accompanied the article "Apartment Lending After the Boom" was labeled incorrectly. The top line (solid) represents total housing units, the middle line shows single-family units and the bottom line depicts multifamily units.



Janet Reilley Hewitt
Editor in Chief

COMING IN OCTOBER

Our annual convention issue tackles the big issues surrounding housing's future frontiers. Products, housing policy, new geographic market frontiers and MBS breakthroughs on the horizon are among the topics we will explore.

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Clocking the Industry's Performance

The mortgage banking industry has been posting better performances lately, as companies pull out all the stops to control costs. The business is getting maximum mileage out of productivity gains—particularly in servicing, MBA's latest Cost Study shows.

Robert M. Rosenblatt

AFTER TWO VERY difficult years, profitability in the mortgage banking industry began to recover in 1989, according to The Mortgage Bankers Association of America's (MBA) 1989 Cost Study, a survey of 145 firms in the mortgage banking industry. The firms surveyed included companies of all sizes, ownership structure and geographic location, whose average volume serviced was $2.4 billion and average origination volume produced was approximately $350 million.

For this report of 1989 data, the individual company data were derived for the first time from the *Mortgage Bankers Financial Reporting Form*. Quarterly submissions of this form are now required from all mortgage banking companies that are approved GNMA, Fannie Mae and/or Freddie Mac seller/servicers. The form contains sections that provide a detailed allocation of annual income and expenses across function (i.e., loan production, warehousing, marketing and servicing).

PHOTOGRAPHY BY ED CASTLE

Overview

The average profit margin (excluding sales of servicing) of the 145 companies that provided detailed statistics

on income and expenses by mortgage banking function was 5.5 percent in 1989, up from averages of 0.7 percent in 1987 and 1.7 percent in 1988 (see Table 1). While an improvement, the average profit margin in 1989 remained well below the 1986 level of 19.6 percent and below the 1984 to 1988 average of 11.3 percent.

A somewhat less-hostile lending environment for mortgage bankers combined with successful efforts to boost productivity and reduce costs in both loan production and servicing were the primary forces behind the improvement in profitability in 1989. While the total loan-origination market did not expand in 1989—remaining at about $480 billion—the mounting troubles of the thrift industry and a declining consumer preference for adjustable-rate mortgages enabled the mortgage banking industry to increase its market share by 3.5 percentage points to 34.5 percent. This increase in market share resulted in a 12 percent gain in origination volume by the mortgage banking industry, from an estimated $148 billion in 1988 to an estimated $161 billion in 1989.

In a further positive development, serious mortgage delinquencies and foreclosures continued to decline in 1989, reducing expenses for provision for loan losses and expenses to service foreclosures and real-estate owned (REO). Higher problem-loan expenses during the previous two years was a major contributing factor to the overall decline in profitability.

The increase in market share and the decline in problem loan expenses complemented ongoing efforts within the industry to increase productivity and reduce costs. These efforts yielded a sizable payoff in 1989. Loans closed in-house, per origination employee rose to 35 from 26 in 1988, reducing average retail origination expenses per loan to 266 basis points from 282 basis points. Similarly, loans serviced per loan-administration employee rose from 616 in 1988 to 696 in 1989, contributing to a decline in direct servicing expenses per loan from 19 basis points to 16 basis points.

Servicing takes off

As mortgage companies strive to adapt to today's changing business environment, mortgage servicing appears to be one of the bright spots. At the average firm, net servicing income in 1989 was $2.7 million, edging out warehousing as the most profitable aspect of the mortgage banking operation, as shown in Table 1. Although servicing profitability was still low by historical standards, it appears that the recent emphasis on containing costs and improving productivity was paying off. The profit margin for servicing, which rose for the second consecutive year, was 26.4 percent in 1989. Moreover, net servicing income as a percent of the dollar volume serviced increased 7 percent in 1989 to 11 basis points (see Table 2).

A positive consequence of management's more intensive efforts to maximize net income from the servicing portfolio was a 24 percent rise in per-loan, net-servicing income (see Table 3). In 1989, net servicing income was $61 per loan compared to $49 per loan in 1988. One of the keys to this improvement was the stability of direct expenses. In 1989, direct expenses rose only 1 percent to $89 per loan. This stability reflected another increase in servicing productivity.

The number of loans serviced per servicing employee rose by 80 loans, or 13 percent, to 696 in 1989, from 616 the prior year. Another contributor to the improvement in net income was the sharp reduction in provisions for loan losses. With delinquency and foreclosure problems abating slightly in 1989, expenses allocated to provision for loan losses fell by 38 percent to $17 per loan.

Partially offsetting these developments was a sharp increase in the amortized cost of purchased servicing (ACPS). Firms in this survey continued to increase their purchases of servicing rights in 1989. As a result, this cost component jumped 40 percent to $66 per loan. In addition, while gross servicing income rose 10 percent in per-loan terms, it fell from 45 basis points to 42 basis points when expressed as a percent of the dollar volume serviced.

Servicing income

Total servicing income per loan, as noted above, rose 10 percent in 1989, to $233 from $211 in 1988, as shown in Table 3. An examination of the various components of income shows that servicing fee income—the bread and butter of the servicing operation—rose 8 percent in 1989 to $199 per loan. This increase is due solely to the 17 percent rise in the average loan size serviced, which went from $46,863 in 1988 to $54,786 in 1989. Servicing fees as a percent of the dollar volume serviced fell 3 basis points to 36 basis points. Other loan administration income increased 21 percent to $36 per loan. Losses on sales of REO were up in percentage terms in 1989, but still remained near the $2 per-loan cost recorded the previous year.

Another common source of income for mortgage companies today, gains from sales of servicing rights, were lower in 1989 for the average firm in the survey. This was in contrast to the real estate finance industry as a whole, where an estimated $155 billion in servicing was transferred in 1989, about the same as in 1988. Given the decline in servicing transfers (based on number of loans transferred) at the average firm in the survey, gains from sales of servicing as a percent of the dollar volume serviced were only 8 basis points in 1989 compared to 14 basis points in 1988. But even with this decline, total servicing income for survey respondents was greatly enhanced by gains related to the sale of

servicing rights. On a per-loan basis, revenues from sales of servicing were $44 in 1989. When this additional source of income was taken into consideration, servicing income jumped to $277 per loan. Moreover, when including gains from the sale of servicing, the profit margin increased to 38 percent, which was very close to the average profit margin during the good years of the early to mid-1980s.

Servicing expenses

Total servicing expenses were $171 per loan in 1989, 6 percent higher than the $162 figure of the prior year. However, as a percent of the dollar volume serviced, total expenses were only 31 basis points, 10 percent less than in 1988. Moreover, direct expenses were nearly unchanged, and the expense category of provision for loan loss registered marked improvement. Essentially all of the increase in costs was concentrated in the amortized cost of purchased servicing.

Direct expenses, the largest component of costs, were $89 per loan in 1989, 1 percent higher than they were in 1988. But even with this per-loan increase, direct expenses as a percent of the dollar volume serviced fell 3 basis points to 16 basis points in 1989.

In recent years, mortgage servicers have begun to effectively use new technology to streamline their basic operations, with the result being higher productivity and lower costs. In 1989, costs declined in a number of key direct-expense categories, including personnel, occupancy and electronic data processing (EDP). All of the increase in direct expenses was in the "other direct expenses" category, and most of this was concentrated in the catch-all, "all other direct expense" subcategory used for miscellaneous expenses.

Personnel costs, which accounted for about 40 percent of direct expenses, declined for the second year in a row (see Table 4). As a percent of the dollar volume serviced, personnel costs fell from 8 basis points in 1988 to 6 basis points in 1989, and on a per-loan basis, fell 6 percent to $35. This drop in personnel costs reflected the increase in productivity. In fact, productivity was at its highest level of the decade. Specifically, in 1989, the number of loans serviced per servicing employee rose by 13 percent, or 80 loans, to 696. In addition to the increase in productivity, other changes likely had an effect on personnel costs in 1989. For instance, evidence indicates that servicing employment fell in 1989. Salaries, however, jumped 29 percent to $24,541. Most likely, the people that were retained were the more-experienced and higher salaried employees.

Occupancy expenses fell for the first time in four years. On a per-loan basis, occupancy expenses were $5 in 1989, 9 percent less than the prior year. Moreover, as a percent of the dollar volume serviced, occupancy expenses fell below 1 basis point in 1989.

TABLE 1

Income and Expenses per Firm (In Thousands)
Average Firm 1987-1989

	1989	1988	1987
Gross Income	$23,305	$24,187	$26,066
Loan Production	4,693	4,529	5,712
Warehousing	7,772	8,104	8,979
Marketing*	594	345	1,770
Servicing	10,246	11,209	9,605
Servicing, Incl Sale of Servicing	12,196	14,759	N/A
Expenses	$22,029	$23,767	$25,880
Loan Production	9,226	9,593	11,023
Warehousing	5,258	5,410	6,699
Marketing*	N/A	172	394
Servicing	7,545	8,592	7,764
Net Income, Total (Before Tax)	$1,276	$420	$186
Loan Production	−4,533	−5,064	−5,311
Warehousing	2,514	2,694	2,280
Marketing*	594	173	1,376
Servicing	2,701	2,617	1,841
Servicing, Incl Sale of Servicing	4,651	6,167	N/A
Memorandum Items:			
Profit Margin (1)	5.5%	1.7%	0.7%
Profit Margin, Incl Sale of Servicing (1)	12.6%	14.3%	N/A
Number of Firms Reporting	145	114	124

* In 1989 marketing data is provided in net income terms only.
[1] The overall profit margin calculations for 1989 are estimates because gross marketing income was not available.

TABLE 2

Trends in Servicing Income and Costs
Average Firm 1980-1989

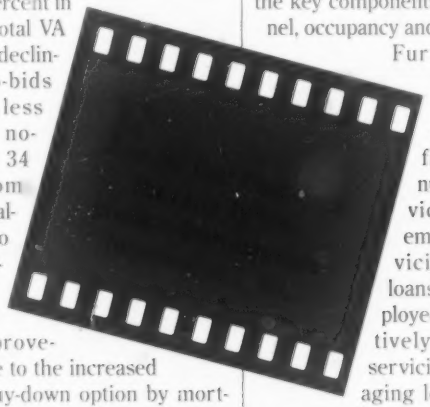
	1989	1988	1987	1986	1985	1984	1983	1982	1981	1980
Percent of Dollar Vol. Serviced:										
Gross Income	0.42	0.48	0.43	0.44	0.46	0.47	0.44	0.46	0.45	0.46
Expenses	0.31	0.37	0.35	0.33	0.25	0.24	0.25	0.23	0.21	0.21
Net Income	0.11	0.11	0.08	0.11	0.20	0.23	0.19	0.23	0.24	0.25
Selected Expenses Per Loan:										
Provision for Loan Losses	$17.05	$27.39	$13.41	$12.19	$4.98	$4.20	$2.43	$−0.09	$0.86	$0.48
Net Gain (Loss) on Sale of REO	$−2.25	$−1.96	$−5.08	$−10.49	$−6.77	$−4.99	$−1.75	$−1.11	$−0.92	$−0.16
Amortized Cost of Purchased Servicing	$65.85	$47.14	$47.09	$39.46	$23.68	$20.15	$17.88	$15.03	$10.58	$10.25
Expenses to Service Foreclosures & REO	$7.91	$8.07	$15.14	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Electronic data processing costs fell for the second consecutive year. In 1989, EDP expenses declined 10 percent to $8 per loan. However, EDP costs per servicing employee rose 1 percent to $5,418. While the changes were moving in opposite directions, these numbers were not inconsistent. The increased use of computer technology in the work place was one of the main reasons for the increase in productivity. In addition, EDP costs fell as a percent of the dollar volume serviced.

The other-direct-expenses category, which includes a number of cost areas, rose 13 percent in 1989 to $40 per loan. As shown in Table 5, most of the increase was in the miscellaneous, all-other-direct-expense subcategory, which rose 16 percent to $27 per loan for the average firm. Two other components of this category, losses on MBS pools and non-EDP depreciation, also rose in 1989. Losses on mortgage-backed security (MBS) pools increased to $4 per loan in 1989 from $3 per loan in 1988, and non-EDP depreciation rose 26 percent to $2 per loan. Expenses to service foreclosures and REO remained at $8 per loan, the same as the previous year.

For the first time since the early 1980s, problem-loan expenses improved in 1989. As a percent of the dollar volume serviced, losses related to delinquency and foreclosure problems—which include provision for loan losses, expenses to service foreclosures and REO and losses on sales of REO—fell to 5 basis points in 1989 from 8 basis points in 1988. Moreover, stated in per-loan terms, problem loan expenses were only $27 in 1989, 27 percent lower than the $37 figure recorded in the prior year. Almost all of the improvement was in provision for loan losses, which fell to $17 per loan in 1989 from $27 per loan in 1988. As a result, provision for loan losses represented only 10 percent of total servicing expenses in 1989 compared to 17 percent the previous year. The other two costs associated with problem loans were about unchanged in 1989. Expenses to service foreclosures and REO remained at about $8 per loan, and losses from sales of REO remained at $2 per loan.

This decline in problem-loan expenses reflected industry-wide improvement in the delinquency and foreclosure situation. Based on data from the Mortgage Bankers Association of America's *National Delinquency Survey*, the percentage of loans 90 days or more past due fell from an average of 0.86 percent in 1988 to 0.79 percent in 1989. In addition, the percentage of loans in the foreclosure process at the end of 1989 was only 0.76 percent, 19 basis points less than it was at the end of 1988. More specifically, total VA foreclosures, which have proven to be very costly, declined 13 percent in the government's fiscal-year 1989, to a total of 41,456. Even more important was the decline in VA no-bids. During fiscal year 1989, the VA used the no-bid option in only 18 percent of its foreclosure decisions compared to 24 percent in 1988. With total VA foreclosures declining and no-bids being used less frequently, no-bids fell by 34 percent, from 11,391 in fiscal-year 1988 to 7,467 in fiscal-year 1989. While some of this improvement was due to the increased use of the buy-down option by mortgage servicers, it was still encouraging to see the decline in no-bids, especially for mortgage bankers, who service an estimated 70 to 75 percent of all VA loans.



In contrast to the stability in direct expenses and the decline in provision for loan losses, the amortized cost of purchased servicing increased 40 percent to $66 per loan in 1989 from $47 per loan in 1988. With this increase, the ACPS rose to 12 basis points as a percent of the dollar volume serviced. While there was quite a bit of variation in the ACPS from firm to firm, the larger the servicing portfolio, the higher the share of purchased servicing (see Table 5). This is in contrast to the sale of servicing rights, which, on a per-loan basis, tended to be highest at the smaller firms. Taken together, it appeared that small firms tended to be net sellers of servicing rights, while the large firms were usually the net purchasers.

Economies of scale

Once again economies of scale were clearly evident in servicing. Table 5 shows that firms with large servicing portfolios tended to have higher levels of productivity and lower direct costs. For instance, at firms with servicing portfolios of less than $500 million, the number of loans serviced per servicing employee was only 384, while for firms with servicing portfolios in excess of $4 billion, the number of loans serviced per servicing employee was 750. As expected, these differences in productivity carried through to lower costs, with total direct expenses declining from $150 per loan for the smallest servicers to $81 per loan for the largest servicers. Within direct expenses, these cost trends held true for most of the key components, including personnel, occupancy and EDP.

Further evidence of economies of scale could be seen by grouping firms by the number of loans serviced per servicing employee. Firms servicing less than 400 loans per servicing employee tended to be relatively small, with servicing portfolios averaging less than $300 million. In contrast, at firms where the number of loans serviced per servicing employee was more than 700, the servicing portfolio averaged $5.4 billion. Again, the cost figures reflected the benefits of higher productivity. Direct expenses for the firms with the highest productivity in the survey were $67 per loan, only about one-third of the average for the lowest productivity group.

Organizational structure

In 1989, as in past years, the profitability of the servicing operation varied by type of business structure (see Table 6). As was the case in 1988, however, the servicing portfolios of privately held companies were more profitable than those at firms with other organizational structures. Net income expressed as a percent of the dollar volume serviced was 25 basis points, more than twice as high as thrift-institution and bank holding company subsidiaries. For these two institutional groups, net income was 12 basis points and 11 basis points, re-

spectively, about the same as at the average firm in the survey. At non-bank, non-thrift subsidiaries ("other subsidiaries") net income was only 7 basis points.

Both higher-than-average servicing income and lower-than-average servicing costs contributed to the solid performance by privately held companies. As a percent of the dollar volume serviced, gross income at privately held companies was 47 basis points in 1989. Thrift institution subsidiaries wer next at 46 basis points. They were fo lowed by non-bank, non-thrift su sidiaries at 44 basis points. Finall servicing income at bank holding cor panies was only 39 basis points.

This high income level at private held companies reflects above-ave age- servicing fees—39 basis poin compared to 36 basis points at the a erage firm—and high-loan-balanc loans. The average size loan service by privately held companies wa $63,892. For the other three owne ship groups, the average size loan se viced ranged from $50,628 to $55,123.

Total servicing expenses for privat ly held companies, expressed as a pe cent of the dollar volume service were only 23 basis points, compared t 31 basis points at the average firm. A bank holding company subsidiaries total servicing expenses were 28 basi points, while at thrift subsidiaries the were 34 basis points, and finally, a non-bank, non-thrift subsidiaries, tota expenses were 37 basis points.

Within expenses, the low per-loa cost for purchased servicing distin guished the privately held companie from the other ownership groups. A privately held companies the ACP was only 4 basis points. This is les than half of what it was at thrift sub sidiaries, the next-closest ownershi group, and one-third that of the aver age firm. This difference in ACPS i consistent with the results by firm size. The servicing portfolios at pr vately held companies were abou $750 million, and smaller firms tende not to be active purchasers of servic ing rights. Direct expenses at private ly held companies were 16 basi points, the same as at the average firm, but 2 basis points higher than bank holding company subsidiaries At non-bank, non-thrift subsidiaries di rect expenses were 17 basis points and at thrift subsidiaries they were 2

TABLE 3

Servicing Income and Expenses per Loan Serviced
Average Firm 1987-1989

	1989	1988	1987
INCOME			
Servicing Fees	$199.06	$183.60	$177.60
First Mortgages (1)	207.53	194.01	173.92
Other Mortgages	2.02	0.34	3.68
Amortization of Excess Servicing	−10.49	−10.75	N/A
Net Gain (Loss) on Sale of REO	−2.25	−1.96	−5.08
Other Loan Administration Income	35.97	29.80	23.79
Total Servicing Income	$232.78	$211.44	$195.81
Net Gain (Loss) on Sale of Servicing	44.30	66.97	N/A
Total Serv Income, Incl Sale of Serv	$277.07	$278.41	N/A
EXPENSES			
Personnel	$35.25	$37.63	$40.84
Loan Administration Employees	29.05	31.54	35.06
Other Personnel Expenses	0.66	N/A	N/A
Fringe Benefits	5.43	5.94	5.63
Education and Training	0.11	0.15	0.15
Occupancy	5.14	5.67	5.38
Electronic Data Processing	7.78	8.69	10.14
Other Direct Expenses	40.34	35.56	41.46
Expenses to Service Foreclosures & REO	7.91	8.07	15.14
Corporate Interest Losses on MBS Pools	3.78	2.99	N/A
Non-EDP Depreciation	1.54	1.22	1.57
All Other Direct Expenses	27.10	23.28	24.75
Total Direct Expenses	$88.51	$87.55	$97.82
Provision for Loan Losses	17.05	27.39	13.41
Amortized Cost of Purchased Servicing	65.85	47.14	47.09
Net Servicing Income (Before Tax)	$61.37	$49.36	$37.49
Memorandum Items:			
Profit Margin	26.4%	23.3%	19.1%
Profit Margin, Incl Sale of Servicing	38.1%	41.8%	N/A
Servicing Income as a % of $ Vol Serv	0.425	0.451	0.428
Servicing Fees as a % of $ Vol Serv	0.363	0.392	0.388
Servicing Expense Ratio (2)	0.162	0.187	0.214
Number of Firms Reporting	145	114	124

(1) Servicing fees on first mortgages represent gross servicing fees.
Prior to 1988 they represented servicing fees on first mortgages less amortization of excess servicing.
(2) Total Direct Expenses as a percent of dollar volume serviced.

TABLE 4

Personnel Expenses
Average Firm 1985-1989

	1989	1988	1987	1986	1985
No. of Loans Serviced per Serv Employee	696	616	570	549	579
Average Salary Loan Admin. Personnel	$24,541	$18,978	$18,324	$16,774	$15,187
Personnel Expenses per Loan Serviced	$35.25	$37.64	$40.84	$37.62	$33.58
Personnel Expenses as a % of $ Vol Serv	0.064	0.080	0.089	0.091	0.090
Per. Expenses as % of Direct Serv Exp.	39.8	43.0	42.0	45.0	51.0

basis points. Provision for loan losses as a percent of the dollar volume serviced was about 3 basis points for all four ownership groups.

High-profit firms

The 10 repeat reporters whose overall profit margin was the highest in the survey in 1989 clearly distinguished themselves in servicing (see Table 7). Compared to the average firm, total servicing income was 22 percent higher, while total expenses were 19 percent lower. This combination of higher revenues and lower costs yielded a net income figure of $145 per loan, more than twice as high as the $61 per loan figure for the average firm. Moreover, net income as a percent of servicing volume was 24 basis points for the high-profit firms versus 11 basis points at the average firm.

Total servicing income for these 10 firms was $283 per loan compared to $233 per loan at the average firm. The main reason for this difference was the size of the average loan serviced by the high-profit firms. At $61,289, the average-size loan serviced by these 10 firms was 12 percent larger than at the average firm. Consequently, servicing fee income was $226 per loan for the

TABLE 5

1989 Servicing Income and Expenses per Loan Serviced Grouped by Dollar Volume of Loans Serviced (In Billions)

	Less than $0.500	$0.500 to $0.999	$1 to $3.999	$4 or More	Average Firm
INCOME					
Servicing Fees	$229.62	$172.11	$211.73	$196.42	$199.06
First Mortgages (1)	233.11	182.65	224.99	203.63	207.53
Other Mortgages	3.89	0.27	2.05	2.07	2.02
Amortization of Excess Servicing	−7.38	−10.80	−15.31	−9.29	−10.49
Net Gain (Loss) on Sale of REO	−0.16	−1.44	−1.46	−2.63	−2.25
Other Loan Administration Income	59.74	27.84	30.65	37.01	35.97
Total Servicing Income	$289.20	$198.51	$240.92	$230.79	$232.78
Net Gain (Loss) on Sale of Servicing	100.81	160.27	96.94	17.78	44.30
Total Serv Income, Incl Sale of Serv	$390.02	$358.79	$337.86	$248.58	$277.07
EXPENSES					
Personnel	$69.62	$45.60	$37.26	$32.27	$35.25
Loan Administration Employees	58.18	38.23	31.01	26.43	29.05
Other Personnel Expenses	1.55	0.76	0.79	0.57	0.66
Fringe Benefits	9.52	6.44	5.34	5.19	5.43
Education and Training	0.36	0.16	0.13	0.08	0.11
Occupancy	8.34	7.43	4.76	4.91	5.14
Electronic Data Processing	14.49	10.51	8.97	6.93	7.78
Other Direct Expenses	57.29	46.80	49.95	36.40	0.34
Expenses to Service Foreclosures & REO	6.08	9.56	5.08	8.64	7.91
Corporate Interest Losses on MBS Pools	3.75	3.25	3.46	3.92	3.78
Non-EDP Depreciation	3.86	2.22	1.78	1.31	1.54
All Other Direct Expenses	43.60	31.78	39.64	22.54	27.10
Total Direct Expenses	$149.74	$110.34	$100.94	$80.51	$88.51
Provision for Loan Losses	15.48	16.80	15.00	17.71	17.05
Amortized Cost of Purchased Servicing	19.08	21.87	32.75	80.65	65.85
Net Servicing Income (Before Tax)	$104.91	$49.50	$92.23	$51.92	$61.37
Memorandum Items:					
Servicing Fees (%)	0.431	0.372	0.357	0.361	0.363
Number of Loans Serv per Serv Employee	384	500	692	750	696
Average Loan Size Serviced	$53,220	$46,239	$59,282	$54,334	$54,786
Average Number of Loans Serviced	3,416	14,425	33,624	216,893	44,016
Average Dol Val of Servicing (Millions)	$182	$667	$1,993	$11,785	$2,411
Number of Firms Reporting	61	26	37	21	145

(1) Servicing fees on first mortgages represent gross servicing fees. Prior to 1986 they represented servicing fees on first mortgages less amortization of excess servicing.

high-profit firms compared to $199 per loan at the average firm. Other servicing income was also quite a bit higher for these 10 firms.

Total servicing expenses for these firms, expressed as a percent of servicing volume, were only 23 basis points compared to 31 basis points for the average firm. Similarly, per-loan expenses were only $139 compared to $171 at the average firm. All three major cost areas were lower for the high-profit firms. But, the big difference was in the amortized cost of purchased servicing.

Direct expenses at the 10 firms were $83 per loan, 6 percent less than at the average firm. Within direct expenses, almost every key cost component was lower. Interestingly, the cost differential in this area does not reflect a higher level of productivity. The number of loans serviced per servicing employee, at 695, was almost identical to the productivity level of the average firm.

Problem-loan expenses at the high-profit firms were $23 per loan, 16 percent less than at the average firm. The key difference was in expenses to service foreclosures and REO. Both provision for loan losses and losses on sales of REO were very close to the survey average. Finally, these 10 firms were not active purchasers of servicing. As a result, their ACPS was only $38 per loan, compared to $66 per loan at the average firm.

Outlook

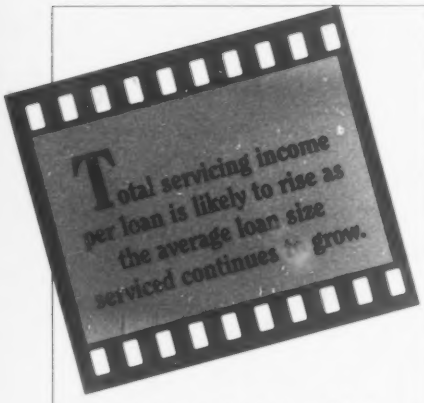
The future prospects for the servicing operation appear promising. Total servicing income per loan is likely to rise as the average loan size serviced continues to grow. Moreover, income generated from the sale of servicing rights will continue to increase in importance as more and more firms

TABLE 6

1989 Servicing Income and Expenses per Loan Serviced Grouped by Type of Ownership

	Bank Holding Company Subsidiary	Thrift Institution Subsidiary	Other Subsidiary	Privately Held Company	Average Firm
INCOME					
Servicing Fees	$178.85	$198.68	$209.35	$248.93	$199.06
First Mortgages (1)	187.61	207.60	219.72	247.06	207.53
Other Mortgages	0.98	0.00	2.01	9.49	2.02
Amortization of Excess Servicing	−9.75	−8.91	−12.39	−7.62	−10.49
Net Gain (Loss) on Sale of REO	−1.49	−0.23	−1.90	−9.94	−2.25
Other Loan Administration Income	32.24	35.41	33.83	63.49	35.97
Total Servicing Income	$209.60	$233.87	$241.28	$302.48	$232.78
Net Gain (Loss) on Sale of Servicing	38.57	57.95	36.53	87.71	44.30
Total Serv Income, Incl Sale of Serv	$248.18	$291.82	$277.81	$390.19	$277.07
EXPENSES					
Personnel	$28.68	$43.76	$38.14	$42.43	$35.25
Loan Administration Employees	23.67	36.18	31.10	36.09	29.05
Other Personnel Expenses	0.20	1.11	0.97	0.88	0.66
Fringe Benefits	4.71	6.25	6.00	5.28	5.43
Education and Training	0.10	0.21	0.06	0.18	0.11
Occupancy	3.38	6.01	6.67	5.55	5.14
Electronic Data Processing	6.76	8.23	8.33	9.57	7.78
Other Direct Expenses	33.88	53.21	42.94	42.68	40.34
Expenses to Service Foreclosures & REO	8.72	8.91	6.66	8.37	7.91
Corporate Interest Losses on MBS Pools	3.06	4.06	4.51	3.66	3.78
Non-EDP Depreciation	1.27	3.15	1.26	1.95	1.54
All Other Direct Expenses	20.83	37.09	30.52	28.70	27.10
Total Direct Expenses	$72.70	$111.21	$96.08	$100.24	$88.51
Provision for Loan Losses	17.25	14.95	17.09	18.67	17.05
Amortized Cost of Purchased Servicing	59.07	45.51	88.23	25.37	65.85
Net Servicing Income (Before Tax)	$60.58	$62.20	$39.89	$158.20	$61.37
Memorandum Items:					
Servicing Fees (%)	0.333	0.392	0.380	0.390	0.363
Number of Loans Serv per Serv Employee	776	594	665	587	696
Average Loan Size Serviced	$53,658	$50,628	$55,123	$63,892	$54,786
Average Number of Loans Serviced	64,207	28,727	79,636	11,727	44,016
Average Dol Val of Servicing (Millions)	$3,445	$1,454	$4,390	$749	$2,411
Number of Firms Reporting	41	25	31	48	145

(1) Servicing fees on first mortgages represent gross servicing fees. Prior to 1986 they represented servicing fees on first mortgages less amortization of excess servicing.



make this a standard part of their servicing operation.

But the noteworthy future developments are likely to be on the cost side. In an effort to increase operating efficiency, mortgage servicers are likely to continue incorporating new technology into the everyday work environment. This should result in further gains in productivity, as well as lower direct costs. While delinquency and foreclosure problems are likely to remain a significant factor, the increased emphasis on quality control hopefully will keep costs in this area to a minimum. Thus on the whole, efficient servicers can expect continued improvement in net servicing income in the years ahead. **MB**

Robert M. Rosenblatt is an economist at the Mortgage Bankers Association of America in Washington, D.C.

TABLE 7

Servicing Income and Expenses per Loan Serviced
Ten High-Profit Firms 1988-1989

	1989	1988
INCOME		
Servicing Fees	$225.90	$165.20
First Mortgages (1)	249.62	184.27
Other Mortgages	0.00	0.00
Amortization of Excess Servicing	−23.72	−19.07
Net Gain (Loss) on Sale of REO	−1.94	−1.43
Other Loan Administration Income	59.06	20.81
Total Servicing Income	$283.03	$184.58
Net Gain (Loss) on Sale of Servicing	61.14	27.77
Total Serv Income, Incl Sale of Serv	$344.17	$212.35
EXPENSES		
Personnel	$34.00	$33.57
Loan Administration Employees	28.01	28.38
Other Personnel Expenses	0.52	N/A
Fringe Benefits	5.30	5.02
Education and Training	0.18	0.18
Occupancy	3.96	2.81
Electronic Data Processing	7.24	5.21
Other Direct Expenses	37.60	36.50
Expenses to Service Foreclosures & REO	3.68	13.23
Corporate Interest Losses on MBS Pools	3.63	6.55
Non-EDP Depreciation	1.29	0.93
All Other Direct Expenses	29.00	15.79
Total Direct Expenses	$82.81	$78.09
Provision for Loan Losses	17.26	26.05
Amortized Cost of Purchased Servicing	38.46	36.16
Net Servicing Income (Before Tax)	$144.5.	$44.28
Memorandum Items:		
Servicing Fee (%)	0.369	0.389
Number of Loans Serv per Serv Employee	695	667
Average Loan Size Serviced	$61,289	$42,481
Average Number of Loans Serviced	28,408	33,615
Average Dol Vol of Servicing (Millions)	$1,741	$1,426
Number of Firms Reporting	10	10

(1) Servicing fees on first mortgages represent gross servicing fees.
Prior to 1988 they represented servicing fees on first mortgages less amortization of excess servicing.

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ECONOMIC TRENDS

Each month, a new batch of housing market statistics is released that provides essential gauges on how the housing sector is doing. Three of the most important releases are housing starts, new home sales and existing home sales. The first of these is produced by the U.S. Department of Commerce; the second is produced jointly by the U.S. Department of Commerce and the U.S. Department of Housing and Urban Development; the final one is prepared by the National Association of Realtors (NAR).

Each one has something a little different to say about the housing sector.

Housing starts—The housing starts report, released around the middle of each month with results from the preceding month, provides data on building permits and housing starts by number of units (e.g., 1-unit, 2-4 units and 5-units or more) and by major census region (e.g., Northwest, Midwest, South and West).

The data are collected through a monthly Census Bureau survey. The process begins by soliciting information on building permits from local governments. Then, a sample of permits is selected, and the owners and/or builders holding the permit are asked if the unit has been started. A unit is considered started when excavation begins for the footings or foundation. In the case of multifamily units, all units are considered started once excavation for the building begins.

If units covered by permits have not yet been started, follow-ups are made to determine if and when a start occurs. Otherwise, the start appears in the housing starts statistics in the survey month. Roughly 60 percent of single-family units are started in the same month in which a permit is issued. However, only about 35 percent of structures with 5-units or more are started in the same month.

New home sales—The survey underlying housing starts is also used in estimating new home sales. In the new home sales report, the number of sales, units for sale and sales prices are reported each month, with the number of sales and units for sale further broken down by region.

The estimates are made by first classifying single-family housing starts into one of four categories:

- "Spec built," where the land and structure are for sale as a unit.
- The unit is being built for the owner on the owner's land by a general contractor.
- The unit is being built on the owner's land with the owner serving as the general contractor.
- Units built for rent.

The first category accounts for about two-thirds of single-family starts and, in this classification scheme, is also the only category associated with new home sales. Consequently, new home sales are a subset of housing starts.

That is not to say, however, that the timing of starts and sales is exactly the same. As noted, a start is recorded once excavation begins. However, a new home sale is recorded when a sales contract has been signed or a deposit has been accepted. Consequently, a sale may be recorded when a couple signs a contract for an unbuilt house after looking at models—a case where the sale would lead the start—or they could buy the model or another completed unit—a case where the start leads the sale. In any case, the two—starts and sales—will ultimately be linked.

Existing homes sales—Existing home sales are based on compilations of transactions reported to NAR by over 550 boards of Realtors across the country. Data on number of units and prices are reported by region each month.

The transactions are not all reported on the same basis. Some boards report transactions as of the signing of a contract, others report transactions at the time of closing. Consequently, in any given month, existing home sales reflect both contracts signed in that month and some of those signed in the preceding few months.

Table 1 shows the three major indicators for the past six years or so. Both single-family housing starts and new home sales peaked in 1986, and are currently 25 to 30 percent below their respective peaks. Existing home sales, on the other hand, peaked in 1988 (although the 1988 peak was only very slightly greater than the 1986 level), then came down, but have since revived to very close to the previous peak.

One possible reason for the discrepancy between new construction—reflected by starts and new home sales—and transactions of already existing units—reflected by existing home sales—is that the latter units tend to be much more moderately priced. The median price of new homes is around $120,000, but the median price of existing homes is only about $102,000. It is possible that affordability constraints pushed more and more buyers away from new homes in the late 1980s and early 1990s, and toward more moderately priced existing homes. That would explain both the lackluster performance in the new home market and the relative stability in the existing home market.

TABLE 1

	Millions of Units, Unless Otherwise Noted		
Year	Single-Family Housing Starts	New Home Sales	Existing Home Sales
1985	1.072	.688	3.214
1986	1.179	.750	3.565
1987	1.146	.671	3.526
1988	1.081	.676	3.594
1989	1.003	.650	3.440
1990	.895	.534	3.296
1991 June	.868	.525	3.590
Percent change, peak to June 1991	−26.4%	−30.0%	−.1%

Thomas M. Holloway
Senior Economist

VITAL STATISTICS

KEY ECONOMIC INDICATORS AND INTEREST RATES

	CHANGES IN PAYROLL EMPLOYMENT (THOUSANDS)	UNEMPLOYMENT RATE (%)	CHANGES IN CONSUMER PRICES FROM YEAR AGO LEVELS (%)		MORTGAGE INTEREST RATES (%)		
			ALL ITEMS	ALL ITEMS LESS FOOD AND ENERGY	SECONDARY MARKET YIELD ON FHA NEW HOME MORTGAGES[1]	FHLMC ARMs	FHLMC FRMs
JUL-90	−166	5.5	4.8	5.0	10.15	8.43	10.04
AUG-90	−109	5.6	5.6	5.5	10.20	8.35	10.10
SEP-90	−47	5.7	6.2	5.5	10.26	8.28	10.18
OCT-90	−131	5.7	6.3	5.3	10.24	8.21	10.18
NOV-90	−221	5.9	6.3	5.3	10.02	8.10	10.01
DEC-90	−140	6.1	6.1	5.2	9.74	7.93	9.67
JAN-91	−203	6.2	5.7	5.6	9.62	7.74	9.64
FEB-91	−258	6.5	5.3	5.6	9.58	7.65	9.37
MAR-91	−258	6.8	4.9	5.2	9.59	7.47	9.50
APR-91	−166	6.6	4.9	5.1	9.61	7.38	9.49
MAY-91	151	6.9	5.0	5.1	9.62	7.22	9.47
JUN-91	−21	7.0	4.7	5.0	9.67	7.24	9.62
JUL-91	−51	6.8	NA	NA	NA	7.23	NA

RATES ON SELECTED SECURITIES (%)

	FEDERAL FUNDS RATE	PRIME COMMERCIAL PAPER (3-Month)	U.S. GOVERNMENT				A-Rated Utility
			6-Month	1-Year	3-Year	10-Year	
JUL-90	8.15	7.99	7.52	7.94	8.26	8.47	9.96
AUG-90	8.13	7.88	7.38	7.78	8.22	8.75	10.29
SEP-90	8.20	7.96	7.32	7.76	8.27	8.89	10.28
OCT-90	8.11	7.98	7.16	7.55	8.07	8.72	10.23
NOV-90	7.81	7.91	7.03	7.31	7.74	8.39	10.07
DEC-90	7.31	7.80	6.70	7.05	7.47	8.08	9.95
JAN-91	6.91	7.10	6.28	6.64	7.38	8.09	9.83
FEB-91	6.25	6.49	5.93	6.27	7.08	7.85	9.54
MAR-91	6.12	6.41	5.92	6.40	7.35	8.11	9.58
APR-91	5.91	6.07	5.71	6.24	7.23	8.04	9.46
MAY-91	5.78	5.92	5.61	6.13	7.12	8.07	9.45
JUN-91	5.90	6.11	5.75	6.36	7.39	8.28	9.53
JUL-91	NA	NA	NA	NA	NA	NA	NA

CURRENT SECONDARY MARKET YIELDS (%)

	GNMA[2]	FNMA[2]	FHLMC[2]
JUL-90	9.66	9.66	9.66
AUG-90	9.80	9.75	9.75
SEP-90	9.86	9.79	9.73
OCT-90	9.84	9.80	9.69
NOV-90	9.63	9.66	9.54
DEC-90	9.22	9.27	9.16
JAN-91	9.17	9.24	9.12
FEB-91	8.81	8.86	8.77
MAR-91	9.00	9.03	8.93
APR-91	8.95	8.98	8.88
MAY-91	8.94	8.95	8.86
JUN-91	9.16	9.18	9.06
JUL-91	9.14	9.17	9.06

SPREADS
(Basis Points)

	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
JUL-90	119	119	119
AUG-90	105	100	100
SEP-90	97	90	84
OCT-90	112	108	97
NOV-90	124	127	115
DEC-90	114	119	108
JAN-91	108	115	103
FEB-91	96	101	92
MAR-91	89	92	82
APR-91	91	94	84
MAY-91	87	88	79
JUN-91	90	90	78
JUL-91	NA	NA	NA

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED
By Type of Institution and By Type of Unit
(Millions of Dollars)

	1-4 UNITS					5+ UNITS					NONRESIDENTIAL				
	Total[3]	Mortgage Bankers	Savings & Loans[4]	Commercial Banks	Life Companies	Total[3]	Mortgage Bankers	Savings & Loans[4]	Commercial Banks	Life Companies	Total[3]	Mortgage Bankers	Savings & Loans[4]	Commercial Banks	Life Companies
JUL-90	38,624	14,990	12,020	11,203	30	1,873	257	871	395	209	14,327	4	476	10,724	2,984
AUG-90	41,054	14,948	12,940	12,710	34	2,629	100	950	1,296	92	20,513	1,258	650	15,178	2,994
SEP-90	36,091	13,871	10,616	11,174	36	1,705	177	854	307	112	17,676	25	576	13,623	3,343
OCT-90	36,570	12,834	11,324	12,013	37	1,965	207	840	689	28	14,120	0	551	10,327	3,041
NOV-90	32,958	13,104	8,750	10,716	43	2,157	211	669	970	122	16,557	0	580	12,618	3,288
DEC-90	29,339	11,380	8,500	9,089	39	2,904	184	760	1,360	349	19,156	0	703	13,695	3,705
JAN-91	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES

(Units in Thousands, Seasonally Adjusted Annual Rates)

	BY TYPE OF UNIT						BY REGION							
	HOUSING STARTS			BUILDING PERMITS			HOUSING STARTS				BUILDING PERMITS			
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Northeast	Midwest	South	West	Northeast	Midwest	South	West
JUL-90	1,155	907	248	1,086	839	247	115	226	492	322	115	228	421	322
AUG-90	1,131	865	266	1,055	817	238	122	240	434	335	114	221	405	315
SEP-90	1,106	893	213	989	778	211	104	239	445	318	111	218	385	275
OCT-90	1,026	861	165	925	747	178	144	230	392	260	114	194	360	257
NOV-90	1,130	823	307	916	710	206	147	232	483	268	108	194	366	248
DEC-90	971	768	203	854	689	165	110	233	395	233	99	181	338	236
JAN-91	847	677	170	802	651	151	86	167	361	233	96	188	306	212
FEB-91	992	825	167	876	739	137	91	301	384	216	99	205	353	219
MAR-91	907	770	137	892	734	158	104	226	390	187	96	204	340	252
APR-91	977	833	144	913	787	126	93	236	395	253	102	210	361	240
MAY-91	989	868	121	966	801	165	114	217	367	291	105	221	379	261
JUN-91	1,040	898	142	999	834	165	148	255	389	248	115	227	391	266
JUL-91	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA

HOME SALES

(Units and Prices in Thousands)

	EXISTING HOMES		NEW HOMES		
	Sold (SAAR)	Median Sales Price (Dollars)	Sold (SAAR)	Median Sales Price (Dollars)	Months Supply At Current Sales Rate
JUL-90	3,320	98.1	541	118.7	8.0
AUG-90	3,410	97.2	525	118.4	8.1
SEP-90	3,160	94.4	504	113.0	8.4
OCT-90	3,070	92.9	465	120.0	8.7
NOV-90	3,150	92.0	480	118.9	8.2
DEC-90	3,130	91.7	464	127.0	8.4
JAN-91	2,900	95.6	414	117.9	9.3
FEB-91	3,160	94.0	488	119.9	8.0
MAR-91	3,220	98.2	495	122.5	7.5
APR-91	3,310	100.3	505	120.7	7.3
MAY-91	3,540	101.1	489	117.1	7.5
JUN-91	3,590	101.9	525	120.0	6.9
JUL-91	NA	NA	NA	NA	NA

VALUE OF NEW PRIVATE CONSTRUCTION PUT IN PLACE

(Units in Billions of 1987 Dollars, Seasonally Adjusted Annual Rates)

	Total[5]	1-Unit	2+ Units	Nonresidential
JUL-90	309.1	97.3	17.1	112.5
AUG-90	301.3	95.3	17.4	106.6
SEP-90	296.7	92.8	16.9	105.6
OCT-90	291.3	90.9	16.7	102.6
NOV-90	285.2	88.0	16.1	100.0
DEC-90	280.6	85.7	16.9	98.5
JAN-91	274.1	81.8	16.3	95.0
FEB-91	270.9	78.6	15.6	96.1
MAR-91	264.5	76.3	15.4	93.3
APR-91	267.9	76.4	14.4	97.5
MAY-91	261.2	80.2	13.9	88.2
JUN-91	261.2	83.8	13.4	84.3
JUL-91	NA	NA	NA	NA

NA—Not Available; SAAR—Seasonally Adjusted Annual Rate

[1]Secondary market gross yields. Numbers shown for each month are the average of yields from the first day of the month shown and the first day of the subsequent month.

[2]Securities for 0- to 30-day delivery.

[3]In addition to the categories shown, the total also includes private pension funds, private MBS conduits, state and local retirement funds, federal credit agencies, mortgage pools, and state and local investment agencies.

[4]Savings & Loans and Mutual Savings Banks.

[5]In addition to the categories of private construction shown, the total also includes these categories: residential improvements, railroads, electric light and power, gas, telephone and telegraph, petroleum pipelines, and farm nonresidential.